

Management Alert



BRACING for BREXIT - after the shock, what now?

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Overview

To the shock of corporate Britain the UK voted last week, by 52% to 48%, to leave the European Union. Within hours of the referendum result the British Prime Minister David Cameron announced that he would be standing down some time before October. The British Pound slumped, and stock markets around the world saw billions wiped off their value.

However, despite the political and market upheaval, the UK's membership of the European Union will continue until it has been formally withdrawn, and that is likely to take several years. In the immediate future, the legal landscape will remain substantially unchanged in many respects.

This note considers the exit (or BREXIT) procedure and timing, alternatives to EU membership and the legal implications of the UK leaving the EU.

Exit procedure and timing

Despite the dramatic market reaction to the BREXIT vote, the process by which the UK will leave the European Union will take several years and, in the meantime, the legal landscape will remain largely unchanged.

The formal first step to exit is the UK notifying the EU of its intention to leave in accordance with Article 50 of the *Treaty on European Union*. Once served, the remaining countries of the EU are then obliged to negotiate with the UK the terms on which the UK will withdraw. The withdrawal agreement will cover not only the terms of the UK's exit but also the nature of the UK's future relationship with the EU.

Under Article 50 the EU treaties will cease to bind the UK after two years from the date the UK serves notice of its intention to leave the EU (although this two-year period could be extended by agreement between the European Commission and the UK Government). The UK Prime Minister David Cameron has indicated that he does not intend to serve an Article 50 notice and that doing so will be for his successor. Accordingly, the two-year timetable for exit may not commence until October this year when the new Prime Minister has taken over. This leaves a period of several months for informal talks between the UK Government and the European Commission and other EU member states.

Once the Article 50 notice has been served, the formal negotiation process is very likely to take at least two years owing to the complexity of the issues and the range of issues to be accommodated. The Government's view (in the lead up to the BREXIT referendum) was that the negotiations could take up to 10 years whereas the successful 'Leave' campaign has indicated its desire that negotiations are concluded before the next UK general election in May 2020, just under four years from now.

In any event, once negotiations are concluded the withdrawal agreement will need to be ratified by the UK and the EU and, in the latter case, this means ratification by all 27 remaining member states which is unlikely to happen quickly.

Alternatives to EU membership

The nature of the UK's ongoing relationship with the EU will directly affect the way in which the UK's legal framework will change when the UK does eventually exit the EU. There are several alternative models the UK could choose according to how close (or not) the UK wishes to remain to the EU. The greater the UK seeks to distance itself from the EU the greater the likelihood of change to the UK's existing legal framework. The alternative models include the following:

- *The European Economic Area (EEA)* - Iceland, Lichtenstein and Norway have a relationship with the EU through membership of the EEA, which enables those countries to participate fully in the 'Single Market'. The Single Market ensures free movement of goods, capital services and persons. It also covers related areas such as consumer protection, company law, environment and social policy, and EEA members are bound by decisions of the European Free Trade Association Court. As a result, if the UK chose to join the EEA after leaving the EU, the UK would remain subject to the vast majority of current and future EU laws.
- *The European Free Trade Association (EFTA)* - A step further from the current position would be for the UK to elect to become a member of the EFTA. The EFTA is a regional free trade association based on numerous free trade agreements with other (EFTA and non-EFTA) countries. Iceland, Lichtenstein and Norway are all EFTA members as is Switzerland, but Switzerland rejected membership of the EEA. Switzerland has over 100 bilateral agreements which give it access to the Single Market in specific sectors. The Swiss arrangements provide for the free movement of goods (but not services) and Swiss goods are required to comply with EU laws in certain areas. Even in areas where compliance is not required (such as consumer protection, employment law and intellectual property), Swiss domestic law is consistent with EU law. Accordingly, even if the UK was to opt for this approach, it would not result in huge change in many areas of UK law despite having to negotiate many separate bilateral agreements.
- *Customs Union* - Turkey has entered into a customs union with the EU that allows Turkey access to the Single Market for goods without the need to pay tariffs, but it is required to levy tariffs on imports of goods from countries outside the customs union. However, a customs union would not apply to services that would make it unattractive to the UK given the importance of the EU to the UK's services sector.
- *Free Trade Agreements* - Like Canada, it would be open to the UK to negotiate a free trade agreement with the EU to facilitate tariff-free trade on specific goods and services. However, while these agreements address various issues such as tariff barriers they are unlikely to extend mutual recognition and the single passporting system for financial institutions, a critically important sector for the UK.
- *The WTO Model* - This is the default or base line position where there are no special agreements or relationships, and the UK simply relies on trade governed by the World Trade Organisation's rules. Under this model the UK and the EU are each in the same position as any other country with which they have no specific agreement. This model would represent the most radical move away from the EU and result in the greatest changes from a legal perspective.

None of the above alternatives to EU membership offers a clear or obvious precedent for the extent, terms or structure of the new relationship between the UK and the EU. Successful conclusion of the negotiation process for a new UK/EU arrangement is likely to be time consuming and difficult given the background to the negotiations and the fact that a number of EU governments and institutions effectively hold a right of veto at some stage in the process.

If the UK elects to join the EEA or the EFTA, it seems likely that current EU laws and regulations would continue to apply and affect UK businesses. By contrast, if the UK opts for a customs union arrangement, free trade agreements or reliance only on the WTO rules, a much greater number of current EU laws would cease to apply and the UK could replace such laws in whatever manner it sees fit.

The legal implications of BREXIT

Until we know what form BREXIT will take and what agreements would replace Britain's membership of the EU, it is difficult to predict the specific legal consequences that would arise following the UK's withdrawal from the EU. The following are some general legal and regulatory issues that may arise from the UK's decision to leave the EU:

- *Contractual issues* - The potential for BREXIT could act as a trigger for the exercise of termination, force majeure, 'material adverse change' and various change of control rights in many different types of contracts. Governing law, territory and jurisdiction clauses could also be impacted, and references to EU legislation or legal concepts may need to be amended. Accordingly, a review of agreements and clauses potentially triggered by BREXIT is recommended.
- *IP rights* - All pan-EU intellectual property ("IP") rights may cease to apply in the UK (such as the European Union Trade Mark or "EUTM"). If so, this would leave only UK national rights or reciprocal rights granted by UK law pursuant to international treaty obligations, and could require businesses to re-apply for protection of their IP or carve out UK rights from existing EU rights. In practice, it is likely that the UK will legislate to preserve these rights as much as possible under any post-BREXIT relationship. Also, all pan-EU court orders issued by a UK court against IP infringers may cease to apply in the EU, and the UK courts may regard pan-EU orders issued by the courts of EU countries as no longer applying in the UK.

The European Patent System is entirely independent of the EU and will be completely unaffected by any changes to EU membership. Once the UK leaves the EU, patent rights for the UK will be obtained in exactly the same way as they are now, by a GB designation at the European Patent Office or as a separate national filing directly at the UK IPO. The only effect of leaving the EU would be that the proposed new EU Unitary Patent would not cover the UK. It is expected that provisions will be made for existing EU trade mark and design registrations to be converted to UK national registrations, with the same filing date as the original EU registrations.

- *Employment issues* - Many employment rights that derive from EU legislation have been enacted in domestic legislation, so will likely remain, such as discrimination and family-friendly employment rights. There is scope for reform in some areas considered unduly burdensome on business, such as collective consultation obligations (subject to union agreements which may continue to apply), and there is also opportunity to reform regimes perceived to lack certainty and create unnecessary burdens and costs for business, such as working time, holiday pay and equal treatment for agency workers. TUPE, another area of law stemming from the EU legislation that is firmly imbedded in domestic legislation as it provides stability to businesses, could either remain unchanged or be made more flexible in the future.
- *Immigration* - During the transition period, the immigration rights of EU nationals in the UK (and UK nationals in the EU) will remain unaffected. After the transition period, it is likely that UK nationals will no longer have the right to work in the remaining EU member states under the current conditions. Likewise, it is anticipated that EU nationals will need to obtain permission to work in the UK, and will need to meet the requirements of the immigration system in place at that time. The Government is likely to introduce a revised version of the Points Based System. The new restrictions will only come into effect after the transition period, as the Government must continue to comply with the right of free movement afforded to EU nationals under the current regulations in the interim. However, advance workforce planning is advised to limit the potential impact on business. For example, EU nationals currently in the UK may wish to document their status by applying for a registration certificate, which will confirm his or her authorization to reside and work in the UK.
- *Financial services* - The City of London, as a primary, global financial centre, is headquarters to leading financial services firms serving markets throughout the world, including the EU. BREXIT presents an opportunity in the long term for a new UK framework for market participants subject to financial services law. In the short term, BREXIT is likely to result in the loss of 'passporting' rights for UK-based, regulated financial services providers, depending on an EU-UK agreement. Legal work required by banks and financial services firms will depend on two primary factors: the extent to which an EU-UK agreement addresses financial services issues and whether the UK joins the EEA with a similar status as, for example, Iceland, Lichtenstein and Norway. It is anticipated that there will be a need to amend documentation to take account of the new regulatory framework that formalises UK status for financial services providers after BREXIT.

A significant proportion of UK financial services regulation is derived from EU legislation, some with direct effect that could fall away automatically (such as the Market Abuse Regulation) while the UK will gain the ability to repeal or modify other regulations, possibly involving grandfathering arrangements pending implementation of new domestic rules.

- *Derivatives and Trading* - Before BREXIT, London market infrastructure was in compliance with European standards, and OTC derivatives trading was subject to the European Market Infrastructure Regulation (EMIR). OTC derivatives trading continues to be subject to EMIR as implemented by the European Securities and Markets Authority (ESMA), in the absence of guidance to the contrary from ESMA. After BREXIT, EU approval of London-headquartered clearinghouses is generally

thought to be necessary. In the absence of an EU-UK agreement on derivatives and other trading, the UK would need to draft and implement new law on trading because existing legislation and technical standards implementing EMIR (as well as regulations such as the Market Abuse Regulation and Capital Requirement Regulation generally have not been expressly incorporated or transposed into UK law. This may take considerable time to accomplish.

Of immediate concern from the perspective of the EU and elsewhere internationally is how UK banks would be governed in the case of market crises with accompanying liquidity concerns. Before BREXIT, substantial work was undertaken to establish an EU framework for crisis management within the banking sector. It is likely that directives such as the EU bank recovery and resolution and EU regulations on insolvency may still apply, but this is not completely clear in the absence of a UK-EU agreement directly addressing this. In any event, BREXIT presents new opportunities for the UK to formalise, streamline and therefore appeal to derivatives and other financial services market participants over the long term, but considerable work at the Government level is necessary in both the short and long term. In the event that subsequent UK trading law diverges from EU regulation, such as EMIR, this would create additional burdens for market participants in, for example, the OTC derivatives market because so much of that \$500 trillion dollar market is international in nature.

- *Competition law* - Certain transactions will no longer benefit from “one stop shop” merger control review under the EU Merger Regulation and will therefore potentially face additional scrutiny from the UK Competition and Markets Authority. BREXIT will potentially allow absolute territorial protection (currently prohibited under EU law) to be granted to distributors in the UK - although depending on the context, such agreements could still be subject to challenge under post-BREXIT UK competition law. Following the BREXIT the UK could potentially choose to diverge from EU competition law, although it seems to us unlikely that this will be a priority area for reform.
- *Divergence of regulatory standards* - Finally, the BREXIT will most likely result in an increasing separation and divergence of laws and standards between Britain and remaining EU member states governing key areas such as data protection, energy, financial services and competition law and health and safety.

Conclusion

Regardless of which BREXIT route is selected by the UK and ultimately agreed with the EU, it is important to remember that major changes to the UK legal landscape will not occur immediately and, instead, may take several years. Such changes will unfold gradually at different times in relation to different areas according to the priorities of the Government and with a new Prime Minister to take office before October it is premature to guess what the Government’s priorities might be. If the UK elects to maintain close economic ties with the EU there may be minimal changes to the laws affecting UK businesses and even if the UK selects the WTO model or to pursue free trade agreements with the EU, many UK products will nevertheless need to continue to comply with EU regulations.

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